

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: McCarthy Analyst: John Pavalasky Bill Number: AB 2794

Related Bills: See Prior Analysis Telephone: 845-4335 Amended Date: May 6, 2004

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Small Refiners Low Sulfur Diesel Fuel Credit/Depreciation Deduction

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced February 20, 2004.
- ☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- ☒ FURTHER AMENDMENTS NECESSARY.
- DEPARTMENT POSITION CHANGED TO _____.
- ☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 20, 2004, STILL APPLIES.
- ☒ OTHER - See comments below.

SUMMARY

This bill would provide a tax credit and an accelerated deduction to taxpayers that make expenditures to produce less polluting diesel fuel.

SUMMARY OF AMENDMENTS

The April 28 and May 6, 2004, amendments make the following changes:

- Characterize the credit as an environmental tax credit, require the fuel to qualify as "ultra-low sulfur diesel fuel," and provide definitions for each term used.
- Require certification of eligible expenses by the California Air Resources Board (CARB).
- Require that the items for which qualified capital costs were paid be placed in service in California before being eligible and requires CARB to certify the date placed in service.
- Provide that the credit be carried forward for a maximum of seven years.
- Strike-out the portions of the credit relating to cooperative organizations.
- Recapture a portion of the credit if the facility is sold, transferred or otherwise disposed of (either directly or indirectly) within five years of the taxable year the taxpayer first claimed the credit.
- Add sunset dates to the credit and accelerated deduction provisions.

Board Position:

_____ S _____ NA _____ NP
_____ SA _____ O _____ NAR
_____ N _____ OUA _____ X PENDING

Legislative Director

Date

Brian Putler

5/24/03

The April 28 and May 6, 2004, amendments resolve all of the implementation and technical considerations contained in the analysis of the bill as introduced February 20, 2004. In addition, several of the policy concerns expressed in the analysis of the bill as introduced February 20, 2004, were addressed. The remaining policy concerns are restated for convenience. However, new technical considerations and a new implementation consideration relating to the amendments are raised. The amendments also impact revenue and a new revenue estimate is provided. In addition, the amendments impact the effective/operative date and the discussion under THIS BILL and new discussions are provided for each provision of the bill. The remainder of the analysis of the bill as introduced February 20, 2004, still applies and is not repeated.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment, and by the specific terms of the bill:

- The credit provisions would be operative for taxable years beginning on or after January 1, 2006, and before January 1, 2012.
- The accelerated deduction provisions would be operative for taxable years beginning on or after January 1, 2004, and are repealed on January 1, 2009.

POSITION

Pending.

Summary of Suggested Amendments

Three technical considerations have been identified with respect to the May 6, 2004, amendments and suggested amendments are provided.

THIS BILL

Environmental Tax Credit

This bill would provide a credit in the amount of five cents for each gallon of ultra-low sulfur diesel fuel:

- Produced in California,
- For taxable years beginning on or after January 1, 2006, and before January 1, 2012,
- By a small refiner, defined as a taxpayer that meets all of the following:
 - Did not have the capacity to process more than 55,000 barrels of crude oil per day.
 - Is not owned or controlled by any refiner that has a combined capacity in all of its California refineries to process more than 55,000 barrels of crude oil per day.
 - Is not owned or controlled by any refiner that has a combined capacity in all its refineries in the United States to process more than 137,500 barrels of crude oil per day.
- The aggregate amount of the credit with respect to any facility would be limited to 25% of the qualified capital costs paid or incurred during the applicable period with respect to that facility for items certified by CARB. The applicable period would begin January 1, 2004, and end on May 31, 2007.

This bill would provide that the CARB must certify that the taxpayer's capital costs are for compliance with specified EPA or CARB requirements and that the items for which the capital costs were paid or incurred have been placed in service by the small refiner. The increase in the basis of any property that might otherwise be increased by a qualified capital cost expenditure would be reduced by any credit allowed.

This bill would allow any unused credit to be carried over a maximum of seven years, or until exhausted, whichever occurs first.

This bill requires that a prorated portion of the credit would be recaptured if the facility is sold, transferred or otherwise disposed of (either directly or indirectly) within five years of the taxable year the taxpayer first claimed the credit.

This bill would repeal the credit provisions on January 1, 2013.

Expensing Deduction

This bill would allow small refiners, as defined for the environmental tax credit, to elect to deduct (in lieu of depreciation) 75% of the qualified capital costs paid or incurred during the period beginning on January 1, 2004, and ending on May 31, 2007, for items certified by CARB that are placed in service by the taxpayer during the taxable year. The basis of those items would be required to be reduced by the amount deducted during the taxable year.

The deduction would be repealed on January 1, 2009.

IMPLEMENTATION CONSIDERATION

The May 6, 2004, amendments for the credit add a provision to the CARB certification that provides that the certification is deemed granted if CARB does not make its determination within 60 days after the request is submitted. This timeframe does not take into account the period in which CARB may be asking the small refiner for supplemental information prior to the determination and the timing of CARB meetings to approve the request for certification. Also, this provision does not allow for the modification of the request for certification by CARB.

TECHNICAL CONSIDERATIONS

This bill requires that a prorated portion of the credit would be recaptured if the facility is sold, transferred or otherwise disposed of (either directly or indirectly) within five years of the taxable year the taxpayer first claimed the credit. However, in the case where the credit is first claimed in 2011, the sunset date for the credit of January 1, 2013, would repeal this section (including the recapture provision) before the full five-year recapture period. This consideration would be resolved by revising the sunset date of the credit sections to January 1, 2017.

The May 6, 2004, amendments to the accelerated deduction provisions allow a small refiner to deduct 75% of qualified capital costs, as defined, for items that are placed in service (rather than "paid or incurred") by the taxpayer during the taxable year. The phrase "paid or incurred" should also be amended to read "placed in service" on page 5, line 7 and on page 8, line 20 for consistency.

In addition, the May 6, 2004, amendments added a January 1, 2009, repeal date. However, in the case of a taxable year beginning before the repeal date of January 1, 2009, and ending after that date, no deduction will be allowed due to the repeal of the section (including the allowance of the deduction) on January 1, 2009. The last full taxable year that the deduction would be allowed is the taxable year beginning on or after January 1, 2008, and before January 1, 2009, (in most cases the calendar year 2008). This consideration would be resolved by revising the sunset date of the expensing provisions to read as follows:

“(c) This section shall not apply to property placed in service in taxable years beginning after January 1, 2008, and is repealed on January 1, 2009.”

Revenue Estimate

The revenue impact of this amendment, under the assumptions discussed below, is estimated to be as follows:

| Revenue Impact of AB 2794 (5/6/04) Enactment Assumed After June 30, 2004 \$ Millions | | | | | |
|--|--------|------------|--------|--------|--------|
| | 2004-5 | 2005-6 | 2006-7 | 2007-8 | 2008-9 |
| Expensing Provision | -0.2 | Negligible | +0.1 | +0.1 | +0.1 |
| Credit Provision | | -0.2 | -1.1 | -1.3 | -1.0 |
| Total | -0.2 | -0.2 | -1.0 | -1.2 | -0.9 |

Revenue Discussion

The prior analysis used a “broad definition” of eligible costs. The amendments, however, require CARB to certify the eligible costs. Estimates above, therefore, reflect a “narrow definition” of eligible costs due to CARB certification requirements.

Discussion with industry experts indicated that by 2006 all the California small refiners would be ready to produce ultra low sulfur diesel (ULSD). However, some small refiners that presently are producing asphalt or otherwise are defunct, would be able to take advantage of the proposal and invest in ULSD producing equipment and processes. The revised revenue estimate takes this possibility into account by assuming some increase in the amount of new ULSD production after 2006.

ARGUMENTS/POLICY CONCERNS

This bill would allow a tax credit and a deduction for qualified expenditures for the production of ultra-low sulfur diesel fuel. The combination of a deduction for 75% of the costs and a credit for up to 25% of those costs means that the state will be subsidizing 100% of the expenditures required by existing state and federal laws or regulations, which is unprecedented.

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

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